BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2004-297-S - ORDER NO. 2005-289

DECEMBER 8, 2005

IN RE: Application of Midlands Utility, Inc. for Approval of New Schedule of Rates and Charges for Sewerage Service Provided to its Customers in Richland, Lexington, Fairfield, and Orangeburg Counties.	)))))	ORDER DENYING REHEARING AND/OR RECONSIDERATION AND GRANTING CLARIFICATION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Petition for Rehearing and/or Reconsideration and Motion for Clarification of Order No. 2005-168 filed by the Office of Regulatory Staff (ORS). Because of the following reasoning, we deny the Petition, but grant the Motion.

The ORS' Petition for Rehearing and/or Reconsideration of Order No. 2005-168 sets forth six allegations of error.

First, ORS states that this Commission erred in approving an increase in Phase-I service revenues of $389,057, since such an amount is not supported by the record, and, specifically, does not comport with amounts proposed by either the Applicant, Midlands Utility, Inc. (Midlands or the Applicant or the Company), or ORS. Further, ORS notes that this Commission did not sufficiently explain its findings in this regard. We disagree with the allegation.

The specific reason that this Commission did not adopt the specific Phase-I revenue figure proposed by either the Company or ORS is that neither entity calculated

the increase based on the Company's proposed rates and charges as included in the Company's Application that reflected the Company's current billing practices.

On page 8 of Order No. 2005-168, we held: "the Commission adopts the number of single family equivalents (SFEs) and revenue as calculated by ORS. See Revised Exhibit DMH-6, Hearing Exhibit 13. However, the Commission finds that, based on the testimony of Company witness Keith Parnell and ORS witness Dawn Hipp, the only pass-through treatment expenses are for those customers having treatment provided by the Town of Winnsboro. According to ORS calculations, this amount was $8,826 for the test year. Therefore, the Commission finds that the test year calculated revenues provided by ORS of $932,972 should only be reduced by $8,826, to reflect pass-through treatment expenses for those customers having treatment provided by the Town of Winnsboro. Including this adjustment produces Service Revenue as adjusted of $924,146." This is demonstrated as follows:

Present Rates	**SFEs #**	**Rate $**	**Amount $**
Collection Only	27,260.32	26.70	727,851
Collection and Treatment	7,037.83	26.70	187,910
Collection Only – Mobile Homes	57.76	20.30	1,173
Collection Only – Pass-Through	440.81	14.22	6,268
Collection Only – Mobile Homes – Pass-Through	87.40	10.81	945
Totals Excluding Outside Treatment	34,884.12		924,146
Outside Treatment Revenue	528.21	16.71	8,826
Totals Including Outside Treatment			932,973

It should be noted that the Service Revenue excluding outside treatment charges as adjusted above of $924,146, and as included in Order No. 2005-168, compares to the service revenue excluding outside treatment charges as presented by ORS in revised

Exhibit DMH-6 and Audit Exhibit A Corrected (Hearing Exhibits 13 and 14, respectively) of $583,389. This difference is due to the ORS eliminating its calculation of certain outside treatment revenue as being pass-through revenue, when, in fact, the record reveals that the only pass-through revenue is from those customers having treatment provided by the Town of Winnsboro.

As stated on page 37 of Order No. 2005-168, "the Commission finds that the rates and charges proposed by the company produce additional gross annual revenues of $389,057 using the SFEs as computed by ORS and including the Company's current billing practices. The testimony of Midlands and the ORS reveal that the Company bills outside treatment customers for the approved collection and treatment rate as if Midlands was providing the treatment. The record also reveals that the only pass-through rates being billed by the Company are for those customers having treatment provided by the Town of Winnsboro. Utilizing these billing practices under present and proposed rates, applied to SFEs as calculated by ORS, produces an increase in rates and charges of $389,057, as shown in the following table:

Approved Rates – Phase-I	**SFEs #**	**Rate $**	**Amount $**
Collection Only	27,260.32	37.90	1,033,166
Collection and Treatment	7,037.83	37.90	266,734
Collection Only – Mobile Homes	57.76	28.43	1,642
Collection Only – Pass-Through	440.81	23.03	10,152
Collection Only – Mobile Homes – Pass-Through	87.40	17.27	1,509
Totals Excluding Outside Treatment	34,884.12		1,313,203
Outside Treatment Revenue	528.21	16.71	8,826
Totals Including Outside Treatment			1,322,030
Increase Excluding Outside Treatment			389,057

It should be noted that the Service Revenue excluding outside treatment charges as adjusted above of $1,313,203 compares to the Service Revenue excluding outside treatment charges as presented by ORS after the Phase-I increase in revised Exhibit DMH-6 and Audit Exhibit A Corrected (Hearing Exhibits 13 and 14, respectively) of $907,198. This difference is due to the ORS eliminating its calculation of certain outside treatment revenue as being pass-through revenue, when, in fact, the record reveals that the only pass-through revenue is from those customers having treatment provided by the Town of Winnsboro.

In any event, Phase-I service revenues of $389,057 are clearly correct, and the first allegation of error is without merit.

Second, ORS states that this Commission erred by adjusting service revenues associated with Phase-II in the amount of $36,564, an amount not stated in testimony. ORS again states that, since neither the Company, nor ORS arrived at this precise figure, that the amount is arbitrary and capricious. Again, however, the reason that Order No. 2005-168 does not provide any citation to the record for the increase found appropriate by the Commission is that neither the ORS nor the Company calculated such an increase based on the Company's proposed rates and charges as included in the Company's Application that reflected the Company's current billing practices.

On page 8 of Order No. 2005-168, the Commission found that "With respect to Phase-II, the testimony and exhibits of ORS witnesses Dawn Hipp and Roy Barnette, as adjusted for adjustments approved herein, show the level of total operating revenues after implementation of Phase-II of the rates are $1,379,071, which reflects adjustments

approved herein and a net authorized increase in operating revenues of $36,564." The Commission further stated on page 39 of Order No. 2005-168 that "The Commission agrees that the service revenues should be adjusted to reflect changes in revenues after construction. The Commission finds that the appropriate adjustment to service revenues after construction (Phase II) should be $36,564 based on SFEs as calculated by ORS and the Company's current billing practices." This is demonstrated as follows:

Approved Rates – Phase-II	**SFEs #**	**Rate $**	**Amount $**
Collection Only	27,260.32	38.95	1,061,789
Collection and Treatment	7,037.83	38.95	274,123
Collection Only – Mobile Homes	57.76	29.21	1,687
Collection Only – Pass-Through	440.81	24.03	10,593
Collection Only – Mobile Homes – Pass-Through	87.40	18.02	1,575
Totals Excluding Outside Treatment	34,884.12		1,349,768
Outside Treatment Revenue	528.21	16.71	8,826
Totals Including Outside Treatment			1,358,594
Increase Excluding Outside Treatment – Phase-II			36,564

It should be noted that the Service Revenue excluding outside treatment charges as adjusted above of $1,349,768 compares to the Service Revenue excluding outside treatment charges as presented by ORS after the Phase-II increase in revised Exhibit DMH-6 and Audit Exhibit A Corrected (Hearing Exhibits 13 and 14, respectively) of $942,397. This difference is due to the ORS eliminating its calculation of certain outside treatment revenue as being pass-through revenue, when, in fact, the record reveals that the only pass-through revenue is from those customers having treatment provided by the Town of Winnsboro.

We therefore reject the second allegation of error.

The third allegation of error in this case is the Commission's approval of an increase in Officers' Salaries so as to furnish a salary for Mr. Ken Parnell. ORS states that Midlands' proposal to increase salaries in the amount of $19,808 does not reflect a known and measurable change. ORS notes that no salary increases were given during the test year, made following the test year, nor reflected in Midlands' records through use of an accrual. ORS therefore takes the position that no increase in Officers' Salaries should have been granted. We disagree.

According to the rebuttal testimony of Keith Parnell, "the $19,808 in question is intended as compensation for my brother Ken Parnell. He has put in substantial hours attending meetings, helping with loan matters, planning and engineering expertise. It is not right that he is disallowed this salary amount. He has saved our customers significant dollars through his participation and contribution to Midlands and our other sister companies. He should not be expected to donate his time." Tr. at 31.

Also, according to the rebuttal testimony of Mr. Charles K. (Ken) Parnell, "My brother Keith Parnell and I are owners of Midlands Utility, Inc. (Midlands), Development Service, Inc. (SI) and Bush River Utilities (Bush River). In addition, Keith and I provide the engineering expertise for our companies and where necessary, we rely on the full range of expertise of HPG and Company." Tr. at 102. Mr. Charles K. Parnell is President of HPG and Company, Consulting engineers. The principal business of the Company is to "engineer, design and manage water and wastewater treatment, water distribution, pumping and storage, wastewater collection, pump stations and force main projects for our clients."

The Commission finds that the proforma adjustment in question was intended to provide a salary for ratemaking purposes for Mr. Charles K. Parnell, Vice-President of Midlands Utility, and that as an officer of the Utility, his compensation for duties performed and engineering expertise furnished to the Utility is justified by the record. This allegation of error by ORS is also without merit.

Next, ORS alleges error in the Commission amortizing rate case expenses over a three-year time period. The ORS states a belief that the Commission erred specifically in allowing $39,590 of rate case expenses to be amortized over a three-year amortization period. Order 2005-168 at 25-27. ORS alleges that the Commission should have amortized $41,676 over a five-year period. Again, we disagree.

The dollar amount contained in the Commission's Order was based on a late-filed exhibit detailing legal fees and other charges of $39,590. Hearing Exhibit 8. The late-filed exhibit consists of the latest available information pertaining to rate case expenses and is proper for use in this proceeding.

The Commission disagrees that a five year amortization period is justified in this case. The ORS determined that it has been approximately seven (7) years since the company filed its last rate case. However, ORS did not use seven (7) years in its computations. ORS apparently believes that five (5) years is appropriate, based upon its own judgment. This is not based upon any objective measure.

As stated in Order No. 2005-168, the Company must complete construction of upgrades to its facilities before Phase-II rates can be placed into effect and undergo an audit by ORS. The Company could be involved in further regulatory proceedings before

the implementation of Phase-II rates. Therefore, the Commission believes that the three year amortization period is proper in this case.

The fourth allegation of error is the allowance of a twenty-five year service life for the company's entire treatment plant. The ORS states that the Commission indicated reliance upon two letters offered by the Company: one from Mr. Jim Stanton from Interstate Utility Sales and another form Mr. Anthony Combs of Combs & Associates, Inc. ORS alleges that the letters do not provide conclusive evidence of a twenty-five year service life and that the letters are hearsay. The letters were offered into evidence as Hearing Exhibit 7 and attached to the testimony of Mr. Charles K. (Ken) Parnell. Contrary to ORS' assertions, the Commission did not rely exclusively upon the letters of Mr. Stanton and Mr. Combs, but, instead, relied upon the complete record in reaching its decision concerning depreciation expenses.

ORS witness Morgan testified that the new wastewater facilities should be depreciated over thirty-two years based on the National Association of Regulatory Utility Commissioners (NARUC) recommendation to follow the Florida Public Service Commission water and wastewater system law. The Commission notes that ORS did not sponsor a witness from NARUC to substantiate the recommendation to use the Florida law.

The Company, in support of its twenty-five year service life, offered the rebuttal testimony of Mr. Charles K. (Ken) Parnell, a registered Professional Engineer, who is Vice-President of Midlands and President of HPG and Company. HPG designs and manages water and wastewater treatment, water distribution, wastewater collection, pump

stations and force main projects for their clients. According to Mr. Parnell, the equipment should have a useful life of no more than twenty years, although a facility may have a structure which could last thirty-two years. Tr. at 104. The Commission relied heavily on Mr. Parnell's testimony, since Mr. Parnell is in the business of engineering and designing wastewater treatment facilities, in reaching its decision to allow the Company's requested twenty-five year service life. In explaining why a twenty year depreciation schedule is appropriate for wastewater treatment plants, Mr. Parnell explained that the equipment requires severe duty and has to perform in a harsh environment and that equipment may not treat to the lower levels due to discharge limits becoming more stringent. Therefore, the purchase and construction of new equipment may be required to treat to lower levels before the original equipment can be fully depreciated. Id.

The allowance of a twenty-five year service life is consistent with our findings with regard to the same type of plant being constructed by Midland's sister company, Bush River Utilities, Inc.

The Commission affirms its original decision with respect to depreciation expense as based on the evidence of record in this case.

The fifth allegation of error by ORS is that this Commission erroneously used interest synchronization to calculate interest expense after construction. We disagree.

On page 44 of Order No. 2005-168, we found that "the interest synchronization method of calculating interest expense should be used. The Commission also finds that a 50% Debt/50% Equity capital structure should also be used since it is more representative of a normal capital structure. Utilizing the Company's allocated Rate Base, including

sewer plant upgrades in Phase-II, a 50% Debt/50% Equity capital structure, and an embedded cost of debt rate of 5.65% produces annualized Interest Expense of $46,078 After Construction (Phase-II)."

According to ORS, "the Commission's approved interest expense adjustment is unsupported by the record, provides no explanation for departing from the record and using interest synchronization as the appropriate method to determine Interest Expense After Construction, and imputes a hypothetical capital structure with no explanation as to why that particular hypothetical capital structure is appropriate." We disagree.

First, the adjustment is fully supported by the record. Since no party furnished a computation of Rate Base, the Commission computed a Rate Base based on the record, consisting of the following components: Gross Plant in Service of $2,739,062 (Audit Exhibit A-2, Hearing Exhibit 14) and Proposed Sewer Plant Upgrades of $1,168,850 (Application Exhibit 3, page 2) amount to Total Plant of $3,907,912. From this amount, Accumulated Depreciation of ($2,288,576)(Audit Exhibit A-2, Hearing Exhibit 14) and Accumulated Depreciation for Plant Upgrades of ($46,754), consistent with our findings concerning Depreciation Expense under Phase-II, were deducted, resulting in Net Plant of $1,572,582. From this amount, Net Contributions in Aid of Construction (CIAC) of ($55,291)(Audit Exhibit A-7, Hearing Exhibit 14) were deducted. Cash working capital was computed as being a proper component of Rate Base based on 12.5% of Operating & Maintenance Expenses of $662,024 and 12.5% of General and Administrative Expenses of $248,226 as approved in Order No. 2005-168, or total Cash Working Capital of $113,781. All of the above components resulted in a computed Rate Base of $1,631,072.

The Rate Base was allocated among the classes of capital, based on a 50% Debt/50% Equity capital structure since, as stated in Order No. 2005-168, "it is more representative of a normal capital structure." This resulted in a Rate Base allocated to Long-Term Debt of $815,536. Applying an embedded cost rate of 5.65%, consistent with our findings in the Bush River Utilities case, Docket No. 2004-259-S (since that rate case involves the same loan agreement) results in annualized interest of $46,078.

We would note that utilizing 50% Debt/50% Equity is a computation used for ratemaking purposes by the Commission, especially in cases concerning small water and wastewater companies, when a capital structure tends to be heavily skewed toward either debt or equity and is improper for calculating return on equity, rate of return, annualized interest, etc. for ratemaking purposes. This calculation is also consistent with the Commission's treatment of Interest Synchronization concerning the same loan agreement in the most recently completed rate cases involving Midlands' sister companies Bush River Utilities (Docket No. 2004-259-S) and Development Service, Inc. (DSI) (Docket No. 2004-212-S). Further, it is consistent with the ORS accounting witness' recommendation concerning Interest Synchronization in DSI, which was approved by the Commission. We are somewhat puzzled by the inconsistency of the ORS position regarding the same loan agreement, but, in any event, we reject the request for rehearing or reconsideration with regard to the holding on Interest Synchronization in Order No. 2005-168.

Next, ORS states that this Commission erred in approving an increase in Plant Expansion and Modification Fees. Page 48 of Order No. 2005-168 states, "the

Commission approves the increase in tap fees, but finds that the hearing record does not support the proposed increase in plant expansion and modification fees. However, the Commission will also increase Plant Expansion and Modification Fees from the currently approved $250.00 to $500.00. This should provide a contribution toward recovery of capital costs being incurred by the Company."

The ORS asserts that "notwithstanding the Commission's acknowledgment that the record did not support the increase in plant expansion and modification fees, the Commission approved an increase in Midlands' Plant Expansion and Modification Fee."

We disagree with the ORS position. Order No. 2005-168 states that the hearing record does not support the proposed increase in plant expansion and modification fees, not that the hearing record did not support any increase in plant expansion and modification fees. The Company was proposing an increase in plant expansion and modification fees from $250.00 to $2,000.00 per single family equivalent (SFE). See Application Exhibit 1 and Exhibit 2, page 6. This Commission found that the proposed increase was not justified by the record. The Company's proposed rate was designed to recover the entire cost of the new treatment plant upgrades through plant expansion and modification fees on a pro rata basis. The Commission found that the plant expansion and modification fees should be increased by the same amount as tap fees, for which the Company provided cost justification, and the increase should provide a contribution toward recovery of capital costs being incurred by the Company. The remainder of the Company's investment will be recovered through depreciation over the useful life of the sewer plant. The ORS allegation of error is without merit.

The last allegation of error by ORS is that this Commission erred by not requiring Midlands to post immediately the statutorily required performance bond. As ORS notes, as per Order No. 2005-168, the Commission held that Midlands shall post a performance bond with a face value of one hundred thousand dollars ($100,000) by the earlier of November 29, 2005, or completion of construction at any of its new treatment facilities. Order No. 2005-168 at 50. ORS agrees that the presently posted $50,000 bond is insufficient, but that it is error to not have Midlands obtain the bond immediately. ORS then quotes S.C. Code Ann. Section 58-5-720, and the pertinent regulations. According to ORS, Midlands must have a minimum bond of $100,000 prior to the Company "operating" or "improving" its utility system, as per the statute. We disagree.

Based upon the testimony in the record, the Commission determined that Midlands could not obtain immediately a $100,000 performance bond. Thus, the Commission set the bonding requirement by the completion of construction of the treatment plant. We believe that requiring Midlands to immediately post a $100,000 performance bond, which it stated it could not obtain, could result in a shutdown of the system, due to the purchase of the bond depleting the Company's finances. Currently, there are no alternative providers of sewer service for Midlands' customers. The Commission has determined that a shut down of the Midlands system would not be in the public interest. No evidence has been presented to change the Commission's determination concerning the ability of Midlands to obtain a performance bond immediately or the harm to the public interest if the system were shut down.

Although we realize, as ORS noted, that the posting of the bond is for the protection of the public, we do not believe that forcing the owners of the utility into a detrimental position financially in order to obtain the bond is the proper thing to do, nor is it in the public interest. We find that it is in the public interest to keep the utility running, while at the same time ordering the utility's owners to come into compliance with the bonding statute by a date in the near future. Only by balancing the current financial integrity of the utility with the ultimate increase in protection that an augmented bond will provide, can the public interest be best served.

Further, as pointed out by ORS, pursuant to the provisions of 26 S.C. Code Ann. Regs. 103-501.3, the Commission can, and hereby does, waive 26 S.C. Code Ann. Regs. 103-512.3 to the extent that it requires an appropriate bond to be provided **prior** to operating the Company's utility system. The Commission believes that compliance with this regulation would create unusual difficulty for the Company as described above.

In contrast to its authority to waive its own regulations upon an appropriate finding, the Commission fully agrees with ORS that it has no authority to waive the statutory requirements of S.C. Code Ann. Section 58-5-720 (Supp. 2004). Indeed, it is not doing so in this ruling. Unlike the provisions of 26 S.C. Code Ann. Regs. 103-512.3, which require appropriate bonding **prior** to operation of a utility system, S.C. Code Ann. Section 58-5-720 has no such prohibition. Rather, the statute requires that, before granting consent to operate a treatment facility, the Commission prescribe as a condition to its consent that the utility **shall** file a bond with sufficient surety. The Commission's order requires that such a bond be filed by the Company, sets out the specific amount

required, and sets a date certain by which the Company **shall** file such a bond. Accordingly, we find the allegation of error to be without merit.

Accordingly, as per the above-stated reasoning, the Petition for Rehearing and/or Reconsideration is denied and dismissed.

With regard to the Motion for Clarification, we find, after due consideration, that it should be granted. ORS has moved and requests that this Commission clarify Order No. 2005-168 with respect to the timeframe under which Midlands is to review all customer deposit accounts and by which Midlands is to adjust and/or refund deposits with the proper accrued interest.

In Order No. 2005-168, this Commission found that Midlands should review all customer deposit accounts and that if the account is found not to meet the deposit retention criteria of the Commission's regulations that Midlands should adjust/refund the deposit with accrued interest. Order No. 2005-168 at 50-51. The Commission also required that Midlands shall comply with the Commission's Order No. 2003-593 and adjust the interest rate for customer deposits from 8% to 3.5% effective January 1, 2004. For those customer deposits which Midlands retained up to and including December 31, 2003, Midlands shall calculate interest at the rate of 8%. The Commission further ordered that Midlands review all customer deposits and adjust/refund proper accrued interest to all accounts. If the account does not meet the deposit retention criteria, then Midlands shall adjust/refund each deposit with proper accrued interest to the customer. Midlands shall also adjust/refund proper accrued interest for those accounts where it is acceptable

to continue to retain the deposit. Midlands shall refund interest on customer deposits at least every two years and at the time the deposit is returned.

ORS requests that the Commission state the timeframe by which Midlands shall review all deposits, adjust/refund proper accrued interest to all accounts, and notify the Commission and ORS of the actions taken with respect to reviewing the deposits and adjusting and/or refunding deposits and accrued interest. ORS requests parameters on the scope of the review and requests that Midlands file, with the Commission and ORS, a written report of its review of its customer deposits, adjustments and refunds made, and deposits retained. ORS therefore requests that the Commission clarify Order No. 2005-168 to reflect the recommendation of a definite timeframe as proposed by ORS witness Hipp. Again, we agree. We believe that March 1, 2006 is an appropriate deadline for Midlands to review all customer deposit accounts and adjust/refund customer deposits and accrued interest, and file with the Commission and ORS a written report of the Company's review. Accordingly, the Motion for Clarification is granted as filed.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Randy Mitchell, Chairman

ATTEST:

G. O'Neal Hamilton, Vice Chairman
(SEAL)